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northwest economic
indicators

NORTHWESTERN NATIONAL BANK OF MINNEAPOLIS AN AFFILIATE OF NORTHWEST BANCORPORATION

Spring 1980 Regional Economic Survey

May 8, 1980

Highlights

- **Economic conditions are expected to deteriorate throughout much of the region during the next six months suggesting the long awaited recession has finally arrived.**
- **A cost-price squeeze has depressed farm income throughout much of the region, with the notable exception of dairy and cow-calf areas. Extremely dry pasture conditions, however, are causing real concern for some cow-calf producers.**
- **Liquidity pressures have eased somewhat at agricultural banks which were most affected by last year's grain handlers strike. Yet, credit conditions generally remain tight as loan repayment rates have plunged.**
- **While sufficient funds are available for crop production expenses, very little credit is being made available for expansion of farm operations and purchases that can be postponed. Farm machinery and equipment sales are expected to be the hardest hit.**
- **Additional government loans may help ease liquidity pressures somewhat at agricultural banks. Many bankers, however, feel that more government credit is not the answer to current farm problems. Instead, farmers need higher prices so they can reduce their debts.**
- **Historically, this region has been less affected by national economic downturns than the national average. Due to depressed farm conditions, a repeat performance is less certain this time around. In most rural towns, farmers and businesses alike will suffer, but most are expected to survive.**
- **Because of its diversified economic structure and the large amount of commercial construction already underway, the Twin Cities will be less seriously affected than many other parts of the region. Oil and gas exploration in the Williston Basin will also help keep parts of North Dakota and Montana relatively strong.**

Dr. Sung Won Son
Senior Vice President and
Chief Economist

Economic Outlook

Our eighth semi-annual survey of Upper Midwest bankers reveals the greatest amount of pessimism concerning the outlook for the regional economy since this survey began in 1976. Indications are that the long-awaited recession is underway.

This picture emerges from survey responses from nearly 700 bankers located in the Twin Cities, Minnesota's Iron Range, and agricultural communities in Iowa, Minnesota, Montana, Nebraska, North and South Dakota and western Wisconsin. The survey was conducted in April.

Twin Cities: Aside from reported weakness in auto sales, retail sales have held up fairly well in the Twin Cities. About 55 percent of the area bankers report retail sales are the same as a year ago, while 35 percent feel they are worse. Clothing sales have been relatively strong, particularly at both the high-quality and discount stores. However, sales are expected to falter.

High inventory carrying costs have made retailers quite cautious regarding inventory levels. However, they still may prove to be too high if sales should decline sharply.

Residential construction has already been hard hit as record-high mortgage rates have priced many potential home buyers out of the market. As a result, the decline in home-building could be at least as severe as the 1974-75 crunch.

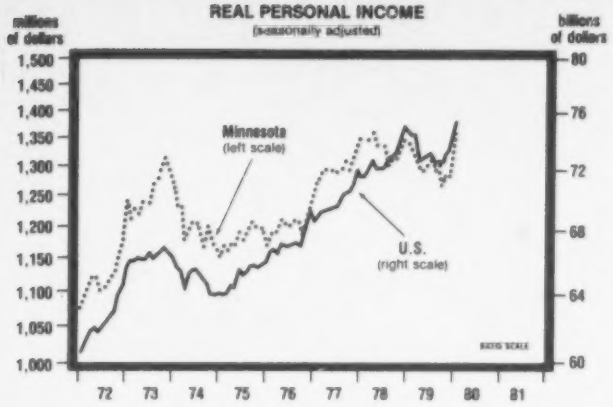
The weakness in the housing sector appears to be spreading. Layoffs have occurred in industries related to home construction, and Twin Cities bankers indicate that major household appliance sales are worse than a year ago.

Three-fourths of the Twin Cities bankers expect economic conditions to get worse during the next six months, while only eight percent expect conditions to improve. Accordingly, the confidence index for the Twin Cities fell to its lowest level since this survey began. Twin Cities bankers report an increasing amount of "fear psychology" among consumers. They believe that excessive concentration on bad economic news may well be a self-fulfilling prophecy.

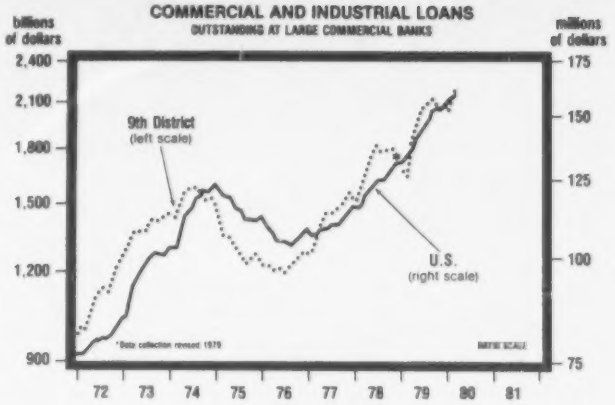
Concern is also expressed over the impact of high interest rates on small businesses in particular. Some Twin Cities bankers expect a serious shakeout of businesses as a result of increased bankruptcies.

REGIONAL ECONOMIC CONDITIONS

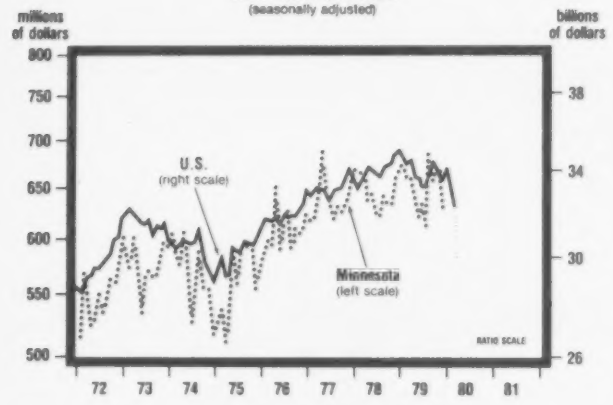
REAL PERSONAL INCOME
(seasonally adjusted)



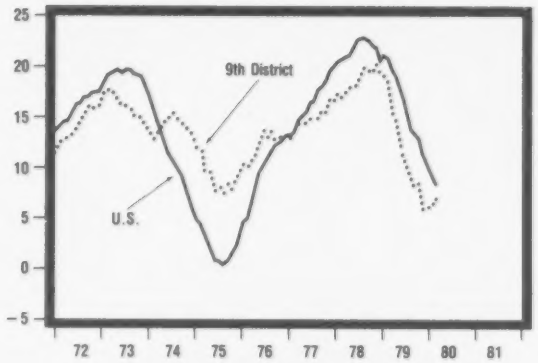
COMMERCIAL AND INDUSTRIAL LOANS
OUTSTANDING AT LARGE COMMERCIAL BANKS



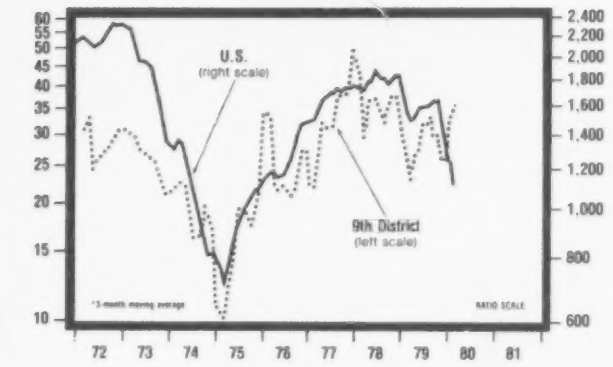
REAL RETAIL SALES
(seasonally adjusted)



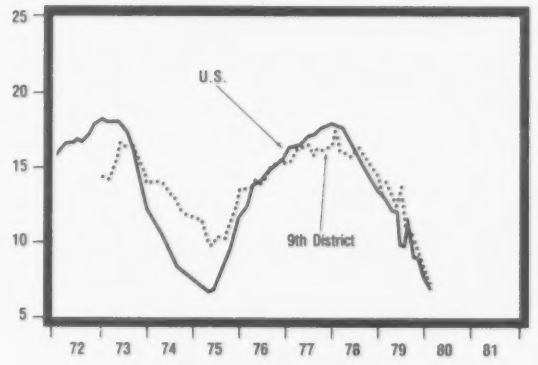
CONSUMER INSTALLMENT CREDIT
OUTSTANDING AT COMMERCIAL BANKS
percent change from a year ago



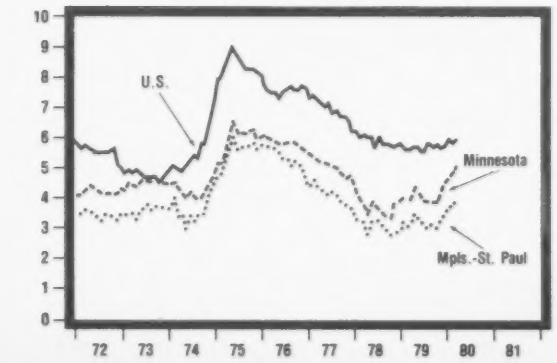
HOUSING UNITS AUTHORIZED
HOUSING UNITS AUTHORIZED BY BUILDING PERMITS
(seasonally adjusted annual rates*)
thousands of units



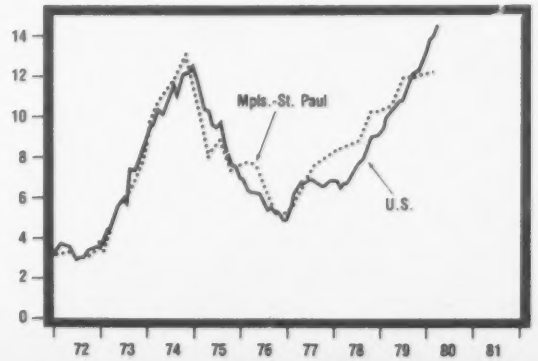
MORTGAGE LOANS
OUTSTANDING AT SAVINGS AND LOAN ASSOCIATIONS
percent change from a year ago



UNEMPLOYMENT RATES
(seasonally adjusted)
percent of labor force



CONSUMER PRICE INDEX
ALL ITEMS, ALL URBAN CONSUMERS
percent change from a year ago



Even so, the recession is expected to be less severe in the Twin Cities than in some other parts of our region. The Twin Cities economy is expected to be buffered by a relatively strong electronics sector, the large amount of commercial construction currently underway and the large concentration of service sector jobs.

Iron Range: Current economic conditions appear to be somewhat weaker in the Iron Range region of Minnesota than in the Twin Cities. Three-fourths of the Iron Range bankers indicate that retail sales are worse than a year ago. Auto sales are depressed as is homebuilding. In addition, over 90 percent of the Iron Range bankers report that capital expenditures on plant and equipment are lower than a year ago, reflecting the completion of certain large construction projects.

About 55 percent of the Iron Range bankers expect economic conditions to get worse during the next six months, while almost 25 percent expect conditions to improve. The bankers quickly add that the economic outlook for northeastern Minnesota depends crucially on the outcome of contract negotiations which began this summer between the mining industry and the steel workers.

Farm Communities: Agricultural bankers' attitudes concerning the economy made a sharp shift from confidence to pessimism since last October's survey. With the notable exception of dairy and certain cow-calf areas, economic conditions are depressed in most farm communities.

Farmers are being squeezed by low crop and livestock prices and skyrocketing fuel, fertilizer, chemical and interest costs. Bankers in western South Dakota, eastern Montana and parts of North Dakota also expressed real concern over the serious shortage of moisture which their wheat and cow-calf producers are experiencing.

Over three-fourths of the agricultural bankers report that farm income is lower than a year ago. However, 85 percent of the bankers in western Wisconsin indicated that farm income is either higher or the same as a year ago. Similarly, over 60 percent of the bankers in western Montana said farm income was either the same or higher than last year. Bankers also report softening land prices in most areas in response to lower farm income.

REGIONAL ECONOMIC SURVEY SUMMARY TABLE
SPRING 1980
BUSINESS CONDITIONS*

(1) Is **farm income** higher or lower than it was a year ago?

	Higher	About the Same	Lower
Ag Banks	7%	16%	77%

(2) Are **retail sales** better or worse than they were a year ago?

	Better	About the Same	Worse
Ag Banks	2%	26%	72%
Twin City Banks	8%	56%	36%
Iron Range Banks	0%	25%	75%

(3) Are farmers (local businessmen) making more or less **capital expenditures** (such as buildings, machinery, and other farm and business equipment) than a year ago?

	More	About the Same	Less
Ag Banks	0%	4%	96%
Twin City Banks	4%	16%	80%
Iron Range Banks	0%	8%	92%

(4) Are **land prices** higher or lower than a year ago?

	Higher	About the Same	Lower
Ag Banks	17%	63%	20%

(5) Do you think the **overall economic condition** in your area will be better or worse six months from now?

	Better	About the Same	Worse
Ag Banks	9%	25%	66%
Twin City Banks	8%	18%	74%
Iron Range Banks	23%	23%	54%

CREDIT CONDITIONS

(6) Are your customers **repaying loans** at a faster or slower rate than they did a year ago?

	Faster	About the Same	Slower
Ag Banks	4%	31%	65%
Twin City Banks	14%	63%	23%
Iron Range Banks	8%	77%	15%

(7) In the past six months did your bank **deny loan requests** due to lack of funds?

	More Than Normal	No More Than Normal	Less Than Normal
Ag Banks	44%	53%	3%
Twin City Banks	39%	57%	4%
Iron Range Banks	46%	46%	8%

(8) Do you think your **loan demand** will be higher or lower six months from now?

	Higher	About the Same	Lower
Ag Banks	55%	35%	10%
Twin City Banks	26%	28%	46%
Iron Range Banks	8%	38%	54%

AGRICULTURAL CONDITIONS

(9) Excluding grain still under CCC loan, are farmers **holding more or less grain** than they did a year ago?

	More	Same	Less
Ag Banks	67%	27%	5%

(10) What affect have transportation problems had on movement of grain in your area?

	Slight	Moderate	Severe
Ag Banks	21%	38%	41%

(11) What changes do you expect in **beef cattle breeding herds** in your area in 1980?

	Increase	No Change	Decrease
Ag Banks	21%	66%	13%

(12) What changes do you expect in **hog breeding herds** in your area in 1980?

	Increase	No Change	Decrease
Ag Banks	9%	31%	60%

*Data show proportion of bankers falling in each of the categories higher, same, lower, etc.

Two-thirds of the agricultural bankers expect overall economic conditions to deteriorate during the next six months, less than 10 percent expect conditions to improve. The greatest amount of pessimism exists in Iowa and Nebraska where 75 to 80 percent of the bankers expect economic conditions to get worse during the next six months. Some agricultural bankers report that there is a serious lack of confidence in the government's ability to control inflation, put its own house in order and stabilize the economy.

Agricultural bankers report that depressed farm income and shattered confidence is already having a serious effect on their farm communities. Farm machinery and equipment sales are among the most seriously affected, although repair business is up significantly. Practically all agricultural bankers reported that farmers are making less capital expenditures for buildings, machinery and farm equipment.

In addition, over 70 percent of the bankers said that retail sales are worse than a year ago. In western Wisconsin, however, less than half of the bankers report weaker retail sales. The general feeling in the rural towns is that farmers and business alike will suffer from depressed farm income. Yet, with everyone working together, most will survive.

Credit Conditions

Twin Cities/Iron Range: In early April, the lending rate charged for working capital loans rose to an average of 18.2 percent at Twin Cities banks, up from 12.0 percent a year ago and 13.2 percent early last October. Starting from similar levels, interest rates charged by Iron Range banks rose to 18.7 percent. These higher rates reflect the rise in costs of purchased funds and the shift toward more costly deposits such as six-month-money-market certificates.

Credit availability also tightened since last fall. About 40 percent of the Twin Cities bankers denied loan applications due to lack of funds. Nearly 60 percent indicated they were less active than normal in seeking new loan accounts.

Even so, the average loan-to-deposit ratio at Twin Cities banks rose to 71.1 percent, up 2.2 percentage points from last fall. Slower deposit growth is at least partially responsible for the tighter liquidity position. Over 50 percent of the Twin Cities banks reported significant deposit losses to treasury issues and money market mutual funds.

The loan-to-deposit ratio at Iron Range banks averaged 70 percent this spring, down from 71 percent a year ago. Even so, the survey results suggest that credit conditions remain tight. Over 45 percent of the Iron Range bankers denied loan requests due to lack of funds and more than 55 percent were less active in seeking new customers.

As a result of high interest rates, credit controls and a weakening economy, both Twin Cities and Iron Range bankers expect loan demand to decline during the next six months, especially for consumer installment loans and mortgages. Commercial and industrial loan demand is also expected to soften, but not by as much as consumer loans. Bankers in both of these localities also indicate that customers are repaying loans somewhat faster than six months ago when repayment rates slipped to their lowest levels since the survey began.

Agricultural Banks: Rapid inflation and credit tightening by the Federal Reserve caused an unprecedented jump in interest rates charged by agricultural banks. Although still lagging the prime rate, the typical interest rate charged for farm operating loans jumped to 17.0 percent, compared to 10.0 percent a year ago and 11.4 percent last fall.

Prior to late 1978, interest rates charged by most agricultural banks were not set up to follow money market rates. However, increased costs of purchased funds and higher rates paid on deposits including a big shift to money market certificates has changed all of this.

Just 18 months ago, six-month-money-market certificates accounted for less than five percent of the time deposits at practically all agricultural banks. Today they account for at least 30 percent of the time deposits at over half of the agricultural banks. As a result, more and more farm loans are either being set up on a variable rate basis or, alternatively, the maturities of fixed rate loans are being shortened.

The loan-to-deposit ratio at agricultural banks averaged 67.8 percent, up 2.2 percentage points from a year ago but down 1.1 points from the record level reached last fall. The most notable easing since last fall occurred at banks in the Red River Valley, reflecting the settlement of last year's grain-handlers strike in Duluth.

Despite the decline in the average loan-to-deposit ratio from last October's level, agricultural credit conditions generally remained tight. Outside the Red River Valley, the loan-to-deposit ratio at agricultural banks in Minnesota eased very little since last fall. And, the ratio actually increased in Iowa and Nebraska.

Moreover, loan repayment rates at agricultural banks fell to their lowest level since the survey began. Bankers note that farmers are reluctant to sell their 1979 crops because prices are considered too low.

Further evidence of tight credit conditions is obtained from the fact that nearly 45 percent of the agricultural bankers turned down loan requests due to lack of funds and 70 percent were less active than normal in seeking new loan accounts.

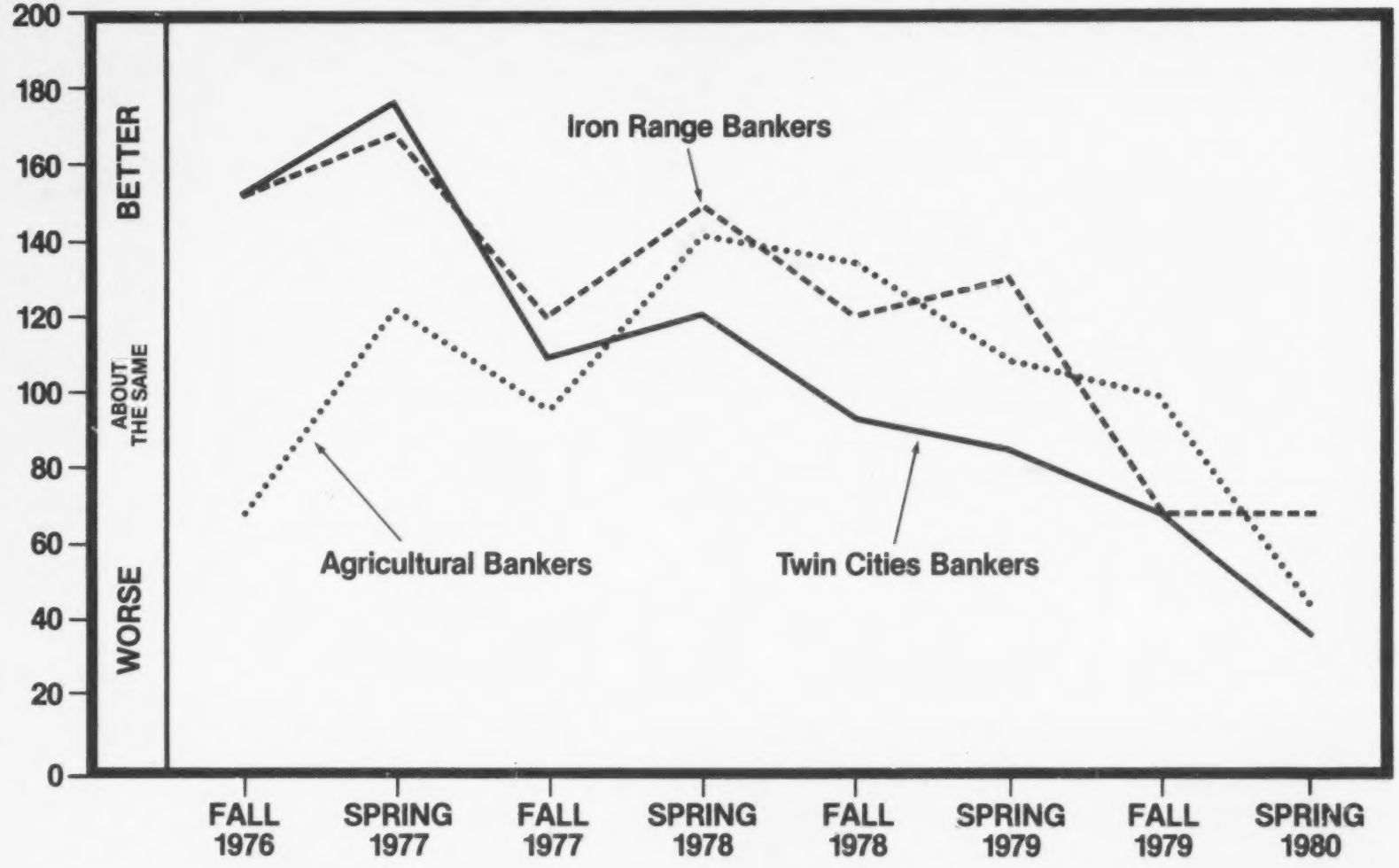
In order to meet the strong loan demand for crop operating expenses, very little credit is being made available for purchases that can be postponed. Loans for machinery, equipment and livestock buildings are expected to decline the most. Agricultural bankers also expect a reduction in loans for grain storage facilities, suggesting that farmers may have less flexibility in marketing grain this fall. In addition, total nonagricultural loan volume is expected to be relatively flat.

Despite an expected slowdown in the overall growth of loans, agricultural bankers feel loan demand will outdistance the growth of deposits. Accordingly, liquidity is expected to remain tight at agricultural banks.

However, increased government loans are likely to ease pressures on rural credit markets. The Economic Emergency loan program of the Farmers Home Administration has been extended through September 1981 and the ceiling on the agency's outstanding loans was increased by $2 billion.

UPPER MIDWEST CONFIDENCE INDEX

Percent of bankers expecting economic conditions to improve
minus percent expecting conditions to deteriorate during the next six months plus 100.



Farmers have also been authorized to enter their 1979 corn crop into the three-year grain reserve program even though they did not comply with acreage set-aside requirements last year. Storage payments and CCC loans are provided to farmers that enter the reserve. Furthermore, since there are no set-aside requirements for the 1980 feed grain and wheat programs, all producers of these crops this year will be eligible for CCC loans, the grain reserve and other farm program benefits.

A number of bankers commented that more credit through government agencies is not the answer to our current farm problems. Instead, farmers need better prices so that they can reduce their debts.

Agricultural Conditions

Grain Storage: Two-thirds of the agricultural bankers report that farmers are holding more grain than a year ago. Farmers are faced with the dilemma of either selling grain at prices they consider too low or paying high interest carrying costs.

In part, bankers blame the large holdings of grain on the embargo, last year's grain-handlers strike and transportation problems. Fifty percent or more of the agricultural bankers in the Minnesota Red River Valley, North Dakota, eastern South Dakota and eastern Montana indicated that transportation problems have had a severe impact on movement of grain. In some areas, availability of transportation was not currently considered to be a serious problem, simply because farmers are not selling grain.

Bankers complained about loss of rail service and unusually large local differences in grain prices depending upon availability of suitable rail service. In addition, the railroad rate structure was considered inequitable in certain parts of the region.

Crop Acreage: In contrast to the USDA's April 1 planting intentions report, bankers expect farmers will boost soybean acreage and decrease corn acreage even though soybean prices are low relative to corn. Currently, the soybean-corn price ratio is about 2.2 to one, a ratio which normally would favor a switch to corn. However, given the higher fertilizer requirements for corn combined with high interest rates, farmers may tend to plant more soybeans in our region.

Farmers are also expected to increase wheat acreage sharply while cutting back sunflower acreage considerably. Overall crop acreage is expected to increase this year due to the elimination of set-aside requirements for wheat and feed grains. Credit availability is not expected to hamper the planting of crops. Thus, we have the potential for another large crop if weather conditions are favorable.

Livestock: Prices are being depressed by both large supplies of pork and poultry and weak consumer demand. Since pork prices have fallen substantially below production costs, agricultural bankers expect hog breeding herds to decline this year. They also expect depressed beef prices to slow the rebuilding of beef cattle herds. However, bankers expect both beef and hog prices to strengthen later this year as large supplies of hogs begin to recede.

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